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E.O. 12958: DECL: 12/02/2016  
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SUBJECT: KOREA'S RAGING REAL ESTATE SPECULATION

Classified By: Classified by Amb. Alexander Vershbow for reasons 1.4 (b  
/d).

#### SUMMARY

1. (C) Korea's speculative fever in metropolitan real estate recently claimed three victims: Construction Minister Choo Byung-jik and two Blue House presidential advisors, Senior Secretary on Public Information Lee Baek-man and Economic Advisor Chung Moon-soo. Their departures were carefully orchestrated in an effort to insulate the Roh administration from its long-standing inability to cool speculation and lower housing prices for young entry-level families. Housing policy is shaping up as a major economic issue as presidential campaigning gets underway for the December 2007 elections. End summary.

#### A FROTHY MARKET

2. (SBU) Seoul is well known as the world's second most expensive city after Tokyo. Several economists argue the Seoul metropolitan area is also well on its way to forming a speculative real estate bubble reminiscent of the Japanese one in the late 1980's. Seoul real estate has quintupled in value over the past decade, with luxurious apartments (4,400 square feet) now selling for USD 6.1 million in Seoul's upscale Kangnam district. Local newspapers frequently print front-page articles on the rampant real estate price inflation, and sharply criticize the Roh administration for its failure to curb speculation. While luxury apartments draw much of the headline attention, the broader concern is that spiraling prices are driving first-time buyers and young people out of the market.

#### ANTI-SPECULATION MEASURES

3. (SBU) With public concern about real estate mounting, Construction Minister Chung Moon-soo and his Blue House colleagues took the lead on supply-side ROKG policies to curb speculation over the past year by:

--announcing several government-sponsored housing projects that will build 867 thousand new units by 2010, largely in densely packed dormitory towns around Seoul.

--lowering bid prices in government housing projects.

--easing construction rules for small apartments to permit increased floor areas.

--weighing additional measures such as requiring private builders to disclose construction costs and, possibly, capping apartment prices in the private sector.

¶4. (SBU) In addition, a new demand-side measure was unveiled to tighten mortgage lending (by capping the debt-to-income ratio to 40 percent) in the wider Seoul area. The lending measure follows on the heels of an August 2006 announcement that capital gains tax on second home sales would rise from 20 to 50 percent, effective 2007. This delayed tax measure only served to add fuel to the speculative fire and further drove house prices up this year, as investment housing flips became more pronounced.

#### THREE HEADS ROLL

¶5. (SBU) Against this backdrop, on November 16, President Roh accepted the resignations of his three top policy makers on housing policy. Construction Minister Choo went because he was publicly outed for investing in an up-scale housing project in downtown Seoul, sparking considerable public outrage. Blue House Advisors Lee and Chung went for their high-profile association with Roh-administration real estate measures; both had conducted public interviews touting the potential success of the measures.

¶6. (SBU) Construction and Transportation Ministry (CTM) contacts note the trio's recent steps constituted the Roh administration's eighth round of measures to cool real estate price rises. One CTM deputy director suggested, after his minister's departure, that the Ministry of Finance and Economy (MOFE) needs to weigh in, raising mortgage rates over the longer term, to dampen demand. Following suit, MOFE raised bank reserve requirements on November 23 from 5 to 7 percent of demand deposits, thereby reducing funds available for mortgages.

¶7. (SBU) Of course, this reserve hike - MOFE's first since 1990 - has engendered even more controversy because it hits hard many first-time buyers and small businesses along with speculators. Just as the reserve requirement starts to bite, construction sector investment is dropping, down 3.9 percent in the second quarter from the preceding quarter ) and down 1.3 percent in the third quarter of this year. The Roh administration's tax and lending measures may be starting to cool real estate demand in combination with a cyclical contraction in the market, just as key policy architects depart their jobs.

#### COMMENT

¶8. (C) High housing costs are a big liability for the Roh administration, as the ruling party coalition struggles to address mounting public perceptions of economic malaise flowing from flagging economic growth, declining exports, and growing income disparity. Indeed, most of our assembly contacts on both sides of the aisle point to housing prices as a major issue likely to dominate campaigning in the lead-up to presidential and national assembly elections in December 2007. The orchestrated departure of three senior officials over housing policy signals the ruling coalition badly wants to regain public trust in its policies. However, many observers feel Seoul metropolitan residents (consisting of about one third of Korea's total population) are too flush with liquidity to cut back on their rampant speculation. As a result, the ruling party coalition seems unlikely to get housing prices to cooperate enough to make it look good in the lead-up to national elections next year. End comment.

VERSHBOW